DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 97-0273
USE TAX
For the 1995 Tax Year

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position regarding a specific issue.

ISSUE

I. Applicability of the Use Tax to Taxpayer's Airplane Purchase.

Authority: 45 IAC 2.2-3-4; 45 IAC 2.2-5-15.

Taxpayer protests the assessment of the use tax on its purchase of an airplane. Taxpayer believes that the initial purchase of the airplane was exempt from use tax because the airplane was purchased for leasing purposes.

STATEMENT OF FACTS

Taxpayer bought an airplane in 1995. At the time of the purchase, taxpayer did not pay sales tax. As a result of the taxpayer's decision not to pay the initial sales tax, the Department assessed the complimentary use tax. After the Department submitted the notice of assessment, taxpayer paid the use tax. Taxpayer requested a refund of the use tax believing that it had been improperly assessed. Upon investigation of taxpayer's refund request, it was determined that the use tax was appropriately assessed and that taxpayer owed additional use tax. In this protest, taxpayer challenges that determination.

Taxpayer entered into an agreement with two lessees for the use the airplane. The two lessees together were charged $15,000 per month for the use of the airplane. Lessee One was charged 75% of the $15,000 while Lessee Two was charged the remaining 25%. Taxpayer, as the lessor, did not contribute to the $15,000 monthly charge. The $15,000 was paid over to and retained by taxpayer in an "airplane account."

Taxpayer has paid sales tax on the $15,000 monthly charges in the belief that these payments constitute lease payments.

Taxpayer's sole owner is also chairman and 74% owner of Lessee One. According to the taxpayer, there is no common ownership between taxpayer and Lessee Two.

In addition to the $15,000 monthly charge, Lessee One and Lessee Two each pay an additional $350 hourly charge covering the time when the airplane is actually used by one of the lessees. On those occasions when the taxpayer uses the airplane, it does not pay the $350 hourly charge. Taxpayer does not pay sales tax on the $350 hourly charges because it believes these costs are not lease payments but are variable costs outside the lease agreement not otherwise subject to sales tax. The $350 hourly charges are paid over and retained by Lessee One in an account separate from that in which the fixed, $15,000 "lease payments" are retained.

Taxpayer does not make the airplane available for lease to parties outside its fixed agreements with the two lessees.

The audit found that the taxpayer's triangular airplane use agreement did not constitute a leasing agreement. Rather, audit determined that taxpayer and the two lessees had entered into an "aircraft partnership" for the purpose of allocating the airplane's fixed operating costs among the three parties.

DISCUSSION

I. Applicability of the Use Tax to Taxpayer's Airplane Purchase.

Taxpayer protests the Department's decision to impose use tax on the purchase of an airplane. The taxpayer is of the opinion that it purchased the airplane for leasing purposes and the initial purchase was not subject to use tax.

Taxpayer was assessed use tax under the authority of 45 IAC 2.2-3-4. The regulation imposes use tax on the purchase of tangible personal property in those instances when the sales tax was not collected at the time of the initial purchase and when the property is "stored, used, or otherwise consumed in Indiana . . . ." 45 IAC 2.2-3-4. In effect, the use tax "piggybacks" on the state sales tax and the relevant sales tax exemptions.

The Department's regulations afford a sales tax exemption for the purchase of property which is leased to others. 45 IAC 2.2-5-15(a) states that "[t]he state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser." In order to qualify for the exemption, the sale must be made to one who (1) purchases the property for reselling, renting, or leasing the property; (2) the purchaser is occupationally engaged in reselling, renting, or leasing the property in the regular course of its business; (3) the property is resold, rented or leased in the same form in which it was purchased. 45 IAC 2.2-5-15(b). 45 IAC 2.2-5-15(c)(2) repeats the admonition that, in order to qualify for the exemption, "[t]he purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business."

Under a plain reading of 45 IAC 2.2-5-15, taxpayer, Lessee One, and Lessee Two are not engaged in a "lease" transaction whereby taxpayer's initial purchase of the airplane qualifies for the use tax exemption. Although taxpayer has provided certain superficial indicia of a "lease" agreement between the three parties, the parties are engaged in a closed, cooperative arrangement by which the fixed and variable costs of operating taxpayer's airplane are apportioned among the parties. In considering the propriety of the parties' "lease" agreement, it should be noted that the agreement was entered into some six months subsequent to the time that taxpayer first submitted its protest to the Department. In practice, the parties closed arrangement – by whatever term one wish to describe that agreement – may serve to satisfy the parties' transportation needs and to equitably apportion the costs of satisfying those transportation needs, but the arrangement is not a "lease" as contemplated by the terms of the regulation.

A number of factors lead inevitably to the conclusion that the parties are not engaged in an "arms length" transaction for the lease of an airplane. First, the parties share a degree of common ownership and management. Second, Lessee One and not – as one would expect in a typical lease transaction – taxpayer is designated as the holder of the hourly charges. Third, curiously enough, the $350 hourly charge is not considered a lease charge and – according to taxpayer – escapes imposition of the state's sales tax. Fourth, the parties' arrangement is closed. The airplane is not available to "lease" to those person's outside the agreement. In summary, taxpayer has entered into an arrangement in which the "lease" payments are fixed, allocable costs. Each "lessee" is simply apportioned a certain percentage of the base costs of maintaining the airplane. This pre-determined apportionment evidences not an agreement by which the parties rent an airplane, but an agreement to jointly share the costs of maintaining the airplane's availability to those parties within the closed agreement.

After considering facts surrounding the parties' aircraft use agreement, it becomes plain that the parties' agreement does not comport with the regulatory standards set out in 45 IAC 2.2-5-15. The regulation requires that the sales tax exemption is available to those purchasers who are "occupationally engaged in reselling, renting or leasing such property *in the regular course of his business.*" 45 IAC 2.2-5-15(c)(2) (Emphasis added). Taxpayer is simply not engaged in renting the airplane in the regular course of its business. Moreover, the regulation admits of no ambiguity in setting forth the requirement. In order to qualify for the exemption, the taxpayer "must" be regularly engaged in the business of renting or leasing. <u>Id</u>.

The original audit, in determining that taxpayer was not entitled to the use tax exemption, described the parties as having entered into an "aircraft partnership." Taxpayer has provided information – including citations to the Indiana Code, Indiana and federal case law, and FAA regulations – which purport to establish that taxpayer and the two "lessees" have not entered into a partnership agreement. However, in the final analysis, taxpayer's citations and the question of whether the parties have entered into a legally recognizable "partnership" are irrelevant. The audit's characterization of the parties' agreement may be nothing more than an unfortunate choice of words. Nonetheless, however one may choose describe the parties' agreement, the agreement is clearly not a "lease" agreement such that the initial aircraft purchase qualified for the sales tax exemption.

FINDING

Taxpayer's protest is respectfully denied.

DK/PE/MR – 011708